Supreme Court of the United States

OCTOBER TERM, 1941.

No._____.

JOHN L. VEST, - - - - - *Petitioner,*

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, RECEIVER OF THE TAYLOR NATIONAL BANK OF CAMPBELLSVILLE, KENTUCKY, - *Respondent.*

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINION OF THE COURT BELOW.

The Opinion of the United States Circuit Court of Appeals for the Sixth Circuit (T. R. 166-173) was handed down on May 14, 1941, and is reported in 119 Fed. (2d) 834.

II.

JURISDICTION.

1. The decree of the United States Circuit Court of Appeals for the Sixth Circuit, a review of which is here sought, was entered May 14, 1941 (T. R. 165),

and a petition for rehearing was denied October 10, 1941 (T. R. 221).

2. The statutory provision which is relied upon to sustain the jurisdiction of this Court is Section 240 of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A., Section 347).

III.

STATEMENT OF THE CASE.

The statement appearing at pages 1 to 6 in the petition for writ of certiorari is hereby adopted and made a part of this brief.

IV.

SPECIFICATION OF ERRORS.

Petitioner intends to urge and rely upon each of the following errors assigned to the decree of the United States Circuit Court of Appeals for the Sixth Circuit:

1. The Court erred in holding that the petitioner violated the National Bank Act in procuring the loan in question and more particularly that section thereof which appears in 12 U. S. C. A., Section 375a, and which is set out *supra* at page 6.

2. The Court erred in holding that in making the loan here involved Morton played the role of borrower only and not that of representative of the Bank.

3. The Court erred in holding this case to be controlled by the decision of this Court in *Deitrick* v. *Greaney* (1940), 309 U. S. 190, thus deciding that this Court in that case overruled its former decision in *Deitrick* v. *Standard Surety & Casualty Co.* (1938), 303 U. S. 471.

V.

ARGUMENT.

The Court Erred in Holding That the Petitioner Violated the National Bank Act in Making the Loan Involved Herein, and More Particularly That Section Thereof Which Appears in 12 U. S. C. A., Section 375a and Which Is Set Out *Supra* at Page 6.

The opinion of the Circuit Court of Appeals assumes that the execution of the original note was a criminal act in contravention of 12 U. S. C. A., Section 375a, *supra.*

It is to be noted that the petitioner was not an executive officer of the Bank. Certainly Morton did not actually borrow $10,000.00 from the Bank and did not become indebted to the Bank. No money was lent or credit extended to any officer of the Bank when the loan was made to the petitioner. The petitioner was solvent and there was pledged to secure the loan collateral of a value materially in excess of the amount borrowed. If the statute was violated, it was because the petitioner intended to deliver the proceeds of the

loan to Morton and relied upon Morton's promise to secure the loan and eventually to pay it.

The opinion of the Circuit Court of Appeals pointed out that under 12 U. S. C. A., Section 592, it is a criminal violation of the National Bank Act for any person, with subversive intent, to aid or abet an officer of a national bank in the willful misapplication of its money, and that by 18 U. S. C. A., Section 550, whoever directly commits any act constituting an offense defined in any law of the United States, or aids, counsels or procures its commission, is a principal. The Court then held that the petitioner, by active connivance with Morton, permitted his note and its renewals to remain as receivables among the assets of the Bank for more than two years for the admitted purposes of concealing the fact that Morton was a borrower from his own bank.

The first statute cited by the Court (12 U. S. C. A., Section 592) is applicable to the instant case only if the petitioner executed the note "with intent to defraud or injure" the Bank by aiding and abetting a willful misapplication of its moneys. The trial court's Finding of Fact conclusively show that such facts did not exist. There was no intent to defraud or injure on the petitioner's part, and no misapplication of the Bank's moneys. The maker of the note was solvent and the collateral was ample. It is true that months later Morton misappropriated the collateral on this particular note, just as he converted collateral on other notes, but the fact that petitioner delivered the pro-

ceeds of the note to Morton had no connection with the subsequent conversion of the collateral.

The second statute relied upon by the Court (18 U. S. C. A., Section 550) is equally inapplicable to the instant case. No act was committed by petitioner constituting an offense unless it was a criminal act for him to borrow money on his own amply secured note, with an agreement that Morton might have the proceeds and pay the loan.

The lending of petitioner's credit to Morton was neither illegal nor immoral. It resulted in no injury to the Bank. The loss was suffered solely by reason of Morton's unlawful conversion of the pledged securities. This conversion occurred at least seven months after petitioner made the note because the collateral which Morton represented to petitioner would be used was found and reported as securing the loan by the National Bank Examiner in his report of September 3, 1935 (T. R. 90). It was then worth $14,300.00.

No loss had then occurred to the Bank. The subsequent conversion of the collateral could not be anticipated. It is submitted that the loss caused by Morton's independent act must fall on the Bank because it selected him and held him forth as worthy of public trust.

The Circuit Court of Appeals held that the petitioner connived with Morton in order that the latter could borrow $10,000.00 from his own bank and thus the pertinent statutes were violated. But the authorities clearly establish that Morton was not a borrower from the Bank and in holding him to be such

it is submitted that the Circuit Court of Appeals committed error.

In *Wagner* v. *Kohn* (C. C. A. 2d), 225 Fed. 718, the receiver of the Mount Vernon National Bank sued to recover on a note made to the bank by the defendant. The note was one made for the accommodation of the Westchester County Brewery Company. The Company had borrowed from the bank all it could obtain and prevailed upon the defendant to execute his note to the bank, secured by collateral furnished by the Company, and to deliver to the Company the proceeds of the loan, which amounted to $2,000.00. The bank converted the collateral and the Receiver sued to secure recovery on the note. The Court held that the defendant was entitled to have set off against his liability on the note the value of the collateral at the time of its conversion, stating:

> "It [the note] is a collateral note, and that fact appears by its recital and the testimony conclusively establishes that the collateral was in fact deposited. The evidence shows that before this action was brought the collateral was surrendered by the bank without defendant's knowledge and cancelled. * * * In the absence of a special agreement to resort first to the collateral, the plaintiff as holder of the note was under no obligation to realize upon the collateral before suing upon the note. * * * On the conversion of the collateral the pledgor was entitled to sue the pledgee *in trover,* and in such an action, the debt being unpaid, the pledgee is entitled to have the amount of the debt deducted from the damages. * * * But the

collateral having been converted, if the pledgee sues the pledgor, should not the same principle be applied, and the value of the collateral be deducted from the amount of the debt? * * * It is true that the bonds deposited as collateral belonged to the Brewery Company and were not the property of the defendant, but we are unable to discover that under the circumstances of this case that fact confers upon the bank or its receiver, as against this defendant, the right to convert the bonds and not be charged with the proceeds in an attempt to recover against him on the note. The defendant had a special property in the bonds so deposited because of the agreement the company made with him. If the Company had not agreed that its bonds might be used as collateral for the note, defendant would have given no note. The money for which the note was given was money paid to enable the Company to discharge its debt to defendant and the understanding between the Company and defendant was that the Company was to pay the note which was given for the accommodation. The collateral was given for the protection of the defendant as well as for the protection of the bank."

As in the case quoted from, so in the case at bar. Neither the letter nor the spirit of the statutory provisions relied upon by the Circuit Court of Appeals prohibited petitioner from borrowing $10,000.00 on a note amply secured by Morton's collateral. The fact that petitioner borrowed this money for Morton's benefit and relied upon Morton's promise to pay the loan was not forbidden by law and did not actually harm

the Bank. Only loans to officers are condemned by the statutory provisions, and where a loan is made to a solvent borrower and secured by ample collateral, the fact that an officer of the bank may be interested in the application of the proceeds from that loan is within the ambit of the statute.

Morton was not liable to the Bank on the note. The Uniform Negotiable Instrument Act in force in Kentucky provides in Section 18:

> "No person is liable on the instrument whose signature does not appear thereon except as herein otherwise expressly provided. But one who signs in a trade or assumed name will be liable to the same extent as if he had signed his own name."

This section was construed in *Marks* v. *Kindle* (C. C. A. 6th), 41 Fed. (2d) 584, where the Court stated:

> "Furthermore, long before the adoption of this Act by the various states, it was the rule in many jurisdictions that the undisclosed principal of the signer of a negotiable paper could not be charged with the act of his agent."

It is stated in *Meachem on Agency,* Vol. 1, Section 1122:

> "Persons dealing with negotiable instruments are presumed to take them on the credit of the parties whose names appear upon them; and a person not a party cannot be charged upon proof that the ostensible party signed or endorsed as his agent."

Since the petitioner was amply solvent and his note was amply secured, there was no actual fraud in the transaction, and since Morton was not the maker of the note, he was not liable thereon.

It has been held in *Seneca County Bank* v. *Neass,* 5 Denio (N. Y.), 329, and in *Pemigewasset Bank* v. *Rogers,* 18 N. H. 255, that where officers who were prohibited by State law from borrowing from their own banks in excess of certain designated amounts prevailed upon third persons to obtain loans with their collateral and to deliver to them the proceeds of the loans, the applicable statutes were not contravened.

In the *Seneca County Bank* case the Court stated:

> "There is nothing in the contention that the original agreement by which Mercer [the bank officer] procured the note of Lee [the accommodation maker] was made in fraud of the Act regulating money to corporations or to deceive the Bank Examiner. The bank had made loans to Mercer beyond what is lawful. Of this he informed Lee. At the same time he requested Lee to let him have his notes with which he could effect his purpose and with which he paid and took up the illegitimate paper. This appears to have been done in good faith and not as a shift to present a temporary appearance of the soundness of the bank. The substituted note appears to have remained permanently the property of the bank. * * * We see nothing wrong in this."

In the *Pemigewasset Bank* case, in discussing the prohibitive State statutes, the Court stated:

> "This section has for its object to prohibit any director to become indebted or liable to the bank to an amount exceeding half his stock by any note, bond or any other promise or undertaking whatever. It may be conceded that any such promise, written or underwritten, would by force of the statute be wholly void.
>
> "But such is not the note under consideration, which is not the evidence of any liability whatever on the part of Rogers [the bank officer]. It has taken the place of a note upon which he was at the time of the exchange legally holden; but he is not a party to this in any form whatever, nor in any way liable to the bank by reason of it."

So, too, in *Patrick* v. *Arkansas National Bank*, 172 Ark. 1103, 292 S. W. 143. A federal statute forbade the bank's lending more than ten per cent of its capital and surplus to one borrower. The Ozark Poultry Company had become indebted to it to that amount. The Company desired a further advance and to circumvent the statute the Company's president and directors executed their note to the bank for the desired advance. The proceeds of the loan were appropriated by the Company. The Court stated that the loan could not be viewed as having been made to the Company, saying:

> "Unquestionably, these individuals, the makers and endorsers of the note, had the right to borrow money from the bank and it was not unusual for them to do so, and lend it to the corporation, of which they were directors and stockholders."

The instant case is much stronger than either of the cases quoted from since in each of those cases the maker of the note had a personal interest served by delivery of the proceeds to the party accommodated. The petitioner here had no such interest.

We submit that the foregoing authorities conclusively establish that the loan to the petitioner was not unlawful. But even if the loan were technically illegal, The Taylor National Bank suffered no damage because of it. The record shows without contradiction that the Bank received a note executed by a solvent maker, attached to which was collateral amply sufficient to secure its payment, and even if it be conceded that the loan was illegal, the Bank was not damaged in advancing that loan. It could have collected its debt in full but for the subsequent conversion of that collateral by Morton. Morton's misappropriation of this particular collateral was only one of many like acts by him. It would have occurred if petitioner had borrowed the money for his own use. If Morton had been replaced as the chief executive officer of the Bank and the collateral subsequently misappropriated by his successor, it could not be contended that the petitioner would be unable to set off against his liability on the note the amount of the converted collateral. In such a case the Bank would be chargeable with the wrongful act of its officer. So, in the instant case, the Bank must bear the loss resulting from Morton's illegal conversion of the collateral. This was the act which caused the loss. Of such misappropriation petitioner had no knowledge.

The theory advanced is lucidly expounded in *United States* v. *Choteau,* 102 U. S. 603. There the United States sued the surety upon a distiller's bond which was conditioned that the distiller shall in all respects comply with the provisions of law relating to the duties and business of distillers. The complaint was that the distiller omitted making true book entries required of him by law and that because of such omissions he was enabled to defraud the United States of internal revenue taxes. The surety answered that the omissions charged in the complaint did not contribute to the loss sustained by the United States, but that the loss was due solely to the distiller's removal of spirits untaxpaid in conspiracy with certain revenue officers. Judgment was for the surety company, the Court stating:

> "It is certainly one way of defending against the charge of a wrongful act for which damages are sought to show that notwithstanding the wrong committed the damages resulted from other causes, however objectionable a pleading might be with averments to that effect instead of a distinct traverse of the allegations of the complaint. If, for example, a party should charge another with inflicting upon his person a wound by which he lost an arm, it would be a good defense to show that the loss resulted from unskillful medical treatment or negligence and not from the wound inflicted. So here it is enough for the sureties to show that the loss to the Government was produced by other means than the particular breach of duty by their principal of which the Government complains. It is of no consequence to them, so far as

the present action is concerned, how many sins of omission or commission he may have committed if they can show that the particular damage claimed was not the result of the one charged."

It is well established that damages to be recoverable must arise as the immediate and natural result of the act done and not from the interposition of additional cause, without which the act done would have produced no harmful result. The execution of the note in the instant case by the petitioner did not result in damage to the Bank. Its loss occurred solely by reason of the illegal conversion of Morton.

The Court Erred in Holding That in Making the Loan Set Out Above Morton Played the Role of Borrower Only and Not That of Representative of the Bank.

At the time the loan was made, Morton was not only the president and chief executive officer of the Bank, but also he owned seventy-six per cent of its capital stock. He was in exclusive control of the Bank and directed all its operations. Where the agent or officer of a corporation is in such complete control and so dominates its affairs, it must be considered that he is the sole agency through which the corporation exercises its will in carrying out its business. Thus Morton was the sole agency representing the Bank in the particular transaction here involved. Under such circumstances, the agent and the principal being identical, it is concluded by all authorities that notice to or knowledge of the agent must of necessity be regarded as

notice to or knowledge of the principal, even though the agent or officer may have an individual interest in the matter adverse to that of the principal. As stated in *Anderson* v. *Missouri State Life Insurance Co.* (C. C. A. 6th), 69 Fed. (2d) 794:

> "When members of a board or committee representing a corporation surrender their powers to an individual, either within or without such board or committee, who completely dominates, and through whom only the corporate powers are exercised, such board or committee is the sole actor with but a single will and purpose, or else the dominant individual is the sole actor and the others are to be ignored as if they did not in fact, as they do not functionally, exist. However considered, the principal is the same. So applying the 'sole actor' doctrine, we cannot distinguish this case either from the third phase of the Kean case, *supra* [Kean v. National City Bank, 294 Fed. 214], or from the holdings of this Court in National City Bank v. Carter, 14 Fed. (2d) 940, and National City Bank v. Carter, 31 Fed. (2d) 25."

The Findings of Fact bring this case well within this rule. In making the loan from the Bank upon the note which he induced the petitioner to sign, Morton was acting within the scope of his authority. Morton being the Bank's sole representative in procuring the note, it cannot claim any right to the note except such as it acquired through him, and it cannot take the benefit of his act without taking also the burdens resulting from the agreement which he made and under which

he procured the note to be executed. The Findings of Fact clearly show a breach of the contract pursuant to which the note was executed and notice of this breach must be imputed to the Bank. *Curtis, Collins & Holbrook Co.* v. *United States,* 262 U. S. 215; *Skud* v. *Tillinghast* (C. C. A. 6th), 195 Fed. 5; *Monroe* v. *Harriman National Bank* (C. C. A. 2d), 85 Fed. (2d) 493; *Connecticut Life Insurance Co.* v. *Commercial National Bank* (C. C. A. 5th), 87 Fed. (2d) 968; *Maryland Casualty Co.* v. *Queenan* (C. C. A. 10th), 89 Fed. (2d) 155.

This Court, in *Rankin* v. *City National Bank,* 208 U. S. 541, and in *Deitrick* v. *Standard Surety & Casualty Co.,* 303 U. S. 471, held that in a suit by the receiver of a national bank to recover the amount of fictitious receivables placed in the bank through the connivance of third persons and bank officials with intent to receive bank examiners, the receiver stood in no better position than the bank, and that since the bank was chargeable with the fraud of its officers the receiver was precluded from recovering from third persons. Under the decisions of this Court we respectfully submit that recovery on the note should be precluded.

The Court Erred in Holding This Case to be Controlled by the Decision of This Court in *Deitrick* v. *Greaney* (1940), 309 U. S. 190, Thus Deciding That This Court in That Case Overruled Its Former Decision in *Deitrick* v. *Standard Surety & Casualty Co.* (1938, 303 U. S. 471.

In *Deitrick* v. *Greaney* (1940), 309 U. S. 190, the defendant, a director of a national bank, was sued by its receiver upon a note knowingly given to the bank as a substitute among its assets for shares of its stock illegally purchased and retained. The bank was prohibited by the National Bank Act (12 U. S. C. A., Section 83) from purchasing and retaining its own shares.

In *Deitrick* v. *Standard Surety & Casualty Co.* (1938), 303 U. S. 471, the defendant had guaranteed certain notes by the execution of guaranty bonds. These bonds were fraudulently issued by the defendant's agent on the assurance of the president of the bank that they were to be "window dressing."

In *Deitrick* v. *Greaney* the defendant was a director of the bank and he had full knowledge of the unlawful purpose of his act. The opinion states that the entire transaction was devised and carried out by him for the unlawful purpose of concealing the bank's ownership of its stock. In the instant case the Findings of Fact conclusively show that the note in question was not given for any unlawful purpose and that when, more than seven months after its execution, the collateral was converted, petitioner reported this fact to the Bank's Board of Directors. Petitioner had no part in

the action which really caused the loss to the Bank. Greaney, on the other hand, formulated the scheme to permit the bank to illegally procure the stock of the bank to be owned in fact by the bank and yet not to so appear. He was the guiding spirit in the transaction. In the instant case there was no violation of any statute by petitioner and there was no illegality in the transaction on his part. Such illegality was present in *Deitrick* v. *Greaney.*

In *Deitrick* v. *Standard Surety & Casualty Co.* there was no allegation that creditors or bank examiners were deceived; none of any loss to creditors resulting from the giving of the note; none that the receiver sued on behalf of creditors, and no cause of action asserted except one to recover upon the note as an asset of the bank. In the instant case the respondent's complaint is rested solely upon the note. As in *Deitrick* v. *Standard Surety & Casualty Co.,* no allegations concerning creditors or bank examiners appear. It is true that none appeared in *Deitrick* v. *Greaney,* but in that case it was apparent that the public policy evidenced by the National Bank Act disabled the defendant, in view of the intended deception, from asserting the lack of consideration for the note. But in *Deitrick* v. *Greaney* it was established that the National Bank Act had been violated. In *Deitrick* v. *Standard Surety & Casualty Co.* a wrong had been perpetrated upon the national banking law which took the form of a deception of bank examiners. The Act itself was not violated. The petitioner in the instant case certainly could be guilty of no more than that of

which the surety company was guilty in *Deitrick* v. *Standard Surety & Casualty Co.* Petitioner's wrong could not be analogous to the offense of Greaney, who perpetrated a criminal act and specifically violated a clear provision of the National Bank Act. The effect of the decree of the Circuit Court of Appeals is to permit the receiver to successfully urge that he represents creditors and not the bank; that the public policy evidenced by the National Banking Act prevents the petitioner from asserting his agreement with Morton. These contentions were held to be unavailing to the receiver under pleadings identical to those of the instant case in *Deitrick* v. *Standard Surety & Casualty Co.,* where the wrong committed was certainly no less than the petitioner's in the instant case.

The Circuit Court of Appeals' decree, therefore, extends the doctrine of *Deitrick* v. *Greaney* in such a way as to contravene the decision of this Court in *Deitrick* v. *Standard Surety & Casualty Co.* We do not believe that this Court intended its decision in *Deitrick* v. *Greaney* to have the effect of overruling its decision in *Deitrick* v. *Standard Surety & Casualty Co.,* and because of the public importance of the question, it should be decided by this Court.

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers by granting a writ of certiorari and reversing the decision of the United States Circuit Court of Appeals for the Sixth Circuit.

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